SUBMISSION

Submission to APRA — Revised Draft Prudential Standard CPS 511 Remuneration

16 February 2021

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File: 2021/04

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

Via email: Policy.Development@apra.gov.au

16 February 2021

Dear Sir/Madam

Revised Draft Prudential Standard CPS 511 Remuneration

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the revised Draft Prudential Standard CPS 511 Remuneration.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.7 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact [redacted], Senior Policy Advisor, on [redacted].

Yours sincerely

[redacted]

[redacted]
Director - Policy Operations, Member Engagement & External Relations

General comments

ASFA appreciates APRA's consideration and incorporation of industry feedback in the revised draft prudential standard CPS 511 Remuneration (CPS 511). In particular, changes to the length of deferral periods and how CPS 511 applies to highly-paid material risk-takers were pragmatic and decreases administrative burden on RSE licensees.

CPS 511 continues to indicate that variable remuneration is an accountability component for an organisation, implying that it might be required for RSE licensees to ensure that appropriate incentives are set for employees. Not all RSE licensees have variable remuneration. The choice of having (or not) variable remuneration is made by each RSE licensee based on their individual circumstances. ASFA considers that APRA should be absolutely clear that variable remuneration is not an accountability requirement.

If an RSE licensee makes the choice to not have variable remuneration, there is a question of whether APRA expects these RSE licensees to have other remuneration accountability measures that would have similar consequences to those proposed in CPS 511. If so, APRA should make clear what these non-variable remuneration accountability measures should be.

Overall, ASFA continues to be concerned about the ability of RSE licensees to compete for talent with other financial services industry participants (for example, private equity funds), as well as participants in other industries. There are many other industries that are not regulated by APRA and therefore would not need to follow CPS 511, particularly with regard to the composition of their variable remuneration.

For example, an investment management professional might have a choice between doing essentially the same job at a superannuation fund, where their variable remuneration will be partly deferred under CPS 511, or at a fund manager where their variable remuneration will be paid in full upon vesting.

Specific comments

Remuneration design

It is not entirely clear whether investment components of variable remuneration are considered non-financial measures. Although it is clear that financial measures include such things as total shareholder return and/or earnings per share metrics, other investment components remain less clear.

In APRA's initial CPS 511 draft, financial performance measures specifically excluded risk-adjusted measures and an RSE licensee's investment return measures. ASFA recommends this specific exclusion continue to be included in the definition of 'financial measures' for clarity.

Interaction with the Financial Accountability Regime (FAR)

The Government is intending to introduce into Parliament legislation implementing the FAR by 30 June 2021. Although draft legislation to implement the FAR has not yet been released, the FAR Proposals Paper released by Treasury for consultation in January 2020 indicates the FAR and CPS 511 will not completely align.

Some examples where the proposed FAR differs from CPS 511 include:

	CPS 511	FAR Proposal Paper
Deferral amounts	• Remuneration is required to be deferred for six years for a CEO and five years for a senior manager and executive director other than a CEO. • Pro-rata vesting *can* occur before deferral period ends.	• Remuneration is required to be deferred for four years for all accountable persons for four years if amount to be deferred is greater than $50,000. • Pro-rata vesting *cannot* occur before deferral period ends.
Terminologies / Definitions	Reference is made to: • material risk-taker • highly paid material risk-taker • senior manager • non-significant financial insignificant institution • significant financial institution	Reference is made to: • accountable persons • key personnel • enhanced compliance entity

The differences between CPS 511 and the proposed FAR creates confusion and requires the application of different tests to determine application.

ASFA recommends CPS 511 more closely align with the FAR in all aspects.

RSE licensees and references to 'group'

Clarification is required in respect of the group application of CPS 511 where an RSE licensee is part of a corporate group but is the only APRA-regulated entity within that corporate group. ASFA's understanding is that, where an RSE licensee is the only APRA-regulated entity within a corporate group, then CPS 511 only applies to the RSE licensee as the only APRA-regulated entity. That is, CPS 511 does not apply on a group basis simply because a RSE licensee, as the only APRA-regulated entity, is part of a corporate group.

If this understanding is correct, ASFA recommends APRA makes clear that CPS 511 only applies to RSE licensees entities alone within a corporate group *unless* the corporate group fulfils the requirements under paragraph 5.

ASFA notes that there are references to 'group' and an RSE licensee's 'connected entities' and 'related bodies corporate' in paragraph 15. This could result in an RSE licensee being classified as a de facto 'Head of a group' as it could encompass quite a number of entities, which may not be the intended result.

The interaction of CPS 511 provisions with, in particular, paragraph 15(a) and footnote 2 creates significant confusion. As such, ASFA recommends CPS 511's drafting more clearly reflect how the references to 'group' apply to RSE licensees.

Clawback and deferral amounts

Circumstances which would lead to CPS 511 requiring clawback to apply is relatively clear in paragraph 55. However, what remains unclear is exactly how RSE licensees can apply and implement clawback. Significant difficulties arise, for example, when the individual resides in a different jurisdiction. Although CPS 511 mentions reasonable steps must be taken by RSE licensees, significant resources could be used in implementing clawback that might outweigh the variable remuneration sought to, or can realistically, be retrieved.

The taxation treatment of clawback also remains unclear. For example, would entities required to recover the amount the individual received after tax and other relevant amounts had been deducted *or* the gross amount that an entity paid (including taxes already paid). Part of the variable remuneration could also have been paid into an individual's superannuation account, which could be difficult to access.

The taxation treatment of deferred variable remuneration also remains unclear. For example, relevant individuals might need to pay tax on deferred variable remuneration when leaving an entity even though it has not yet vested. ASFA recommends APRA discuss with ATO the tax consequences of both clawback and deferred variable remuneration for both entities and individuals. Outcomes from the discussion should be conveyed to the industry.

Risk and financial control personnel

While reference is made to 'risk and financial control personnel' in CPS 511, it does not clarify how these personnel are to be identified. It can be interpreted, broadly, to include all personnel who work within the finance, risk or audit function of an RSE licensee. We consider this extensive capture of personnel to fall outside the intent of the prudential standard. If CPS 511 intends the scope of personnel who fall within this category to be narrower, this needs to be made clear.

Commencement date of CPS 511

CPS 511 is proposed to apply for RSE licensees that are a significant financial institution (SFI) on 1 July 2023 and RSE licensees that are non-SFIs on 1 January 2024. Realistically, if an RSE licensee has a financial year that spans 1 July to 30 June, a commencement date of 1 January 2024 would require entities to be compliant by 30 June 2023.

A commencement date for CPS 511 that considers an entity's financial year and their remuneration cycle would make it far easier administratively for an entity to implement CPS 511, bearing in mind that some RSE licensees have different financial years that don't necessarily fall into a standard 1 July to 30 June financial year.

Enhanced review of third-party service providers

CPS 511 requires a risk assessment of third-party service providers. Clarity is required on exactly what the nature and scope of these risk assessments entails.

Disclosure

The overarching theme for CPS 511 is to require entities to apply financial consequences for poor risk management. Financial consequences include, for example, reductions in variable remuneration or clawback of variable remuneration. In the event that these consequences arise, publicly disclosing the individual to which these consequences were applied to could cause significant reputational damage and conflict with legal and privacy considerations. Furthermore, it might discourage employees from reporting risk incidents.

RSE licensees could, instead, formally notify APRA on a confidential basis that an employee's variable remuneration had been reduced. This would show that appropriate financial consequences had been applied.

ASFA agrees with APRA that a more standardised approach to remuneration disclosure for entities would be beneficial. However, consideration should be given to the depth of remuneration disclosure as some remuneration information, such as performance metrics, can be commercially sensitive.

ASFA also recommends quantitative remuneration information is only disclosed for those that are considered 'accountable persons' under the FAR. Accountable persons are generally senior enough within an organisation to be public facing, with the capacity to impact an organisation's reputation.